

Message Text

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FM AMEMBASSY BONN

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INFO AMEMBASSY LONDON

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AMCONSUL BREMEN

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UNCLAS SECTION 01 OF 04 BONN 15383

DEPARTMENT PASS TREASURY, FRB AND CEA

E.O. 11652: N/A

TAGS: EFIN, GW

SUBJECT: CHANCELLOR'S ECONOMIC POLICY STATEMENT IN
THE BUNDESTAG

REF: BONN 15019

1. SUMMARY. CHANCELLOR SCHMIDT BEGAN A LONG DEBATE ON
THE GOVERNMENT'S ECONOMIC POLICY WITH HIS OWN SPIRITED
DEFENSE OF THE GOVERNMENT'S PERFORMANCE AND EXPLANATION
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OF ITS PROPOSED PROGRAMS WHICH, HOWEVER, CONTAINED

NOTHING NOT PREVIOUSLY HEARD. HE SAID THE RECESSION IS DUE LARGELY TO INTERNATIONAL FORCES OVER WHICH THE GOVERNMENT HAS NO CONTROL; DOMESTIC POLICY RESPONSES, WHICH HAVE BEEN AMPLE AND EFFECTIVE, HAVE BEEN LARGELY CANCELED OUT BY THE EXPORT DECLINE. GOVERNMENT EXPENDITURE INCREASES ARE DUE TO RECESSION INDUCED REVENUE SHORT-FALLS ON THE ONE HAND AND UNEMPLOYMENT BENEFIT SUBSIDIES ON THE OTHER. OVER THE MEDIUM TERM, HE SAID, IT IS NECESSARY NOT TO OVERCROWD THE CAPITAL MARKET AND THEREBY IMPEDE THE ECONOMIC RECOVERY; THEREFORE IT WAS DECIDED TO RAISE THE VAT. WHILE THE OPPOSITION HAS DEMANDED ADDITIONAL SAVINGS, BY CONTRAST THERE ARE INTERNATIONAL PRESSURES THAT HAVE DEMANDED LESS SAVINGS AND INCREASED DEFICITS. A FURTHER INCREASE IN REAL WAGES DOES NOT HAVE AS HIGH A PRIORITY AS IMPROVING INVESTMENT PROPENSITY AND SAFEGUARDING JOBS. WHILE THE GOVERNMENT'S ACTION DEMONSTRATED STRENGTH AND HONESTY, THE OPPOSITION HAS ONLY DEMANDED MORE SAVINGS BUT HAS FAILED TO IDENTIFY WHO SHOULD BE AFFECTED AND BY HOW MUCH. OPPOSITION LEADER KOHL RESPONDED BY BLAMING THE RECESSION ON THE CHANCELLOR, SAYING THAT PRIVATE INVESTMENT HALTED LONG BEFORE THE WORLD CRISIS OCCURRED. THE SPD TOOK OVER A HEALTHY ECONOMY WHICH IS NOW BEING LED INTO CRISIS, THE PRODUCT OF POLICIES WITH SOCIALIST TENDENCIES, HE SAID. KOHL OFFERED HELP BUT ONLY AFTER THE GOVERNMENT PUBLICLY ADMITTED THE TRUE DIMENSIONS OF THE FINANCIAL MISERY. OPPOSITION FLOOR LEADER CARSTENS ACCUSED THE CHANCELLOR OF HAVING MISLED THE PUBLIC AND ALLEGED THAT THE GOVERNMENT ECONOMY PROGRAM IS RATHER ONE OF TAX INCREASES. THE CURRENT PROBLEMS ARE THE RESULT OF 4 YEARS OF POOR ECONOMIC AND SOCIAL POLICIES, HE CHARGED. SUGGESTED WAS THAT THE CHANCELLOR MUST TAKE THE "PERSONAL CONSEQUENCES" FOR HIS ERRORS. END SUMMARY.

2. CHANCELLOR HELMUT SCHMIDT ADDRESSED THE BUNDESTAG ON SEPTEMBER 17 IN WHAT WAS LABELED A GOVERNMENT STATEMENT ON THE FINANCIAL AND ECONOMIC POLICY DECISIONS OF THE FEDERAL GOVERNMENT. THE NOMINAL REASON FOR HIS APPEARANCE WAS TO PRESENT TO THE BUNDESTAG FOR LEGIS-

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LATIVE CONSIDERATION THE DM 15 BILLION 1975 SUPPLEMENTARY BUDGET AND THE DM 5.75 BILLION ECONOMIC STIMULATION PROGRAM. HOWEVER, THE CHANCELLOR SEIZED UPON THE OPPORTUNITY TO DELIVER A 65-PAGE SPEECH THAT TOUCHED ON A BROAD RANGE OF ECONOMIC TOPICS. FOR THE MOST PART NOTHING WAS SAID THAT HADN'T BEEN SAID MANY TIMES BEFORE. IT WAS, HOWEVER, ONE MORE OCCASION TO PUT FORTH, IN A VERY WELL-PUBLICIZED DEBATE, THE GOVERN-

MENT'S POINTS OF VIEW ON WHAT HAS BECOME ITS SOMEWHAT
CONTROVERSIAL AND POLITICALLY LOADED ISSUE OF ECONOMIC
AND FISCAL POLICY. THESE HAVE BEEN MUCH CRITIZED, AND
SCHMIDT'S EFFORT WAS PART APOLOGIA, AND PART SALES-

MANSHIP. SUMMARIZED BELOW ARE THE SALIENT POINTS OF THE
CHANCELLOR'S ADDRESS:

A. A LARGE PORTION OF THE SPEECH WAS GIVEN OVER
TO THE OFT-HEARD EXPLANATION THAT THE GERMAN RECESSION
IS ONE THAT HAS ITS ORIGIN IN THE INTERNATIONAL
RATHER THAN THE DOMESTIC SPHERE. WORLD INFLATION, THE
BREAKUP OF THE INTERNATIONAL MONETARY SYSTEM, AND THE
OIL PRICE SHOCK ALONG WITH THE CONSEQUENT BALANCE OF
PAYMENTS PROBLEMS OF MOST IMPORTANT TRADING COUNTRIES

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WERE CITED AS FACTORS IN THIS CONNECTION. THE HEAVILY EXPORT DEPENDENT GERMAN ECONOMY COULD THEREFORE NOT HELP BUT BE UNFAVORABLY AFFECTED BY THE WORLD RECESSION.

B. IN SPITE OF ALL THIS, EVERYBODY THOUGHT EARLIER THIS YEAR THAT THE WORLD ECONOMY AND HENCE THAT OF GERMANY HAD REACHED THE TROUGH AND WAS ON ITS WAY UP. GERMANY WAS NOT ALONE IN MAKING THIS MISTAKEN FORECAST. HOWEVER, WHAT HAPPENED WAS THAT THE WORLD RECESSION DEEPENED STILL FURTHER AND BROUGHT WITH IT THE DEVELOPMENT OF HIGH UNEMPLOYMENT. NEVERTHELESS, THE GERMAN UNEMPLOYMENT RATE IS AMONG THE LOWEST IN THE EEC.
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C. IT WAS NOTED THAT THE BASIC DECISION TO OPEN THE FRG TO INTERNATIONAL ECONOMIC FORCES WAS AN IMPORTANT ONE, FOR WHICH CREDIT MUST BE GIVEN TO KONRAD ADENAUER AND LUDWIG ERHARD. HOWEVER, THE OPENING OF THIS DOOR ALSO BROUGHT WITH IT THE RISK THAT SOMETHING SUCH AS WHAT IS CURRENTLY HAPPENING WOULD OCCUR. DESPITE THIS, HOWEVER, THERE WAS NO DESIRE ON THE PART OF THE SOCIAL-LIBERAL COALITION TO CHANGE THE POLICY OF AN INTERNATIONALLY OPEN ECONOMIC SYSTEM.

D. SCHMIDT POINTED OUT THE DISTINCTION BETWEEN THE 1966-67 RECESSION AND THE PRESENT ONE BY SAYING THAT THE EARLIER RECOVERY WAS NOT THE RESULT SOLELY OF GOVERNMENT MEASURES BUT RATHER OF A MASSIVE BOOM IN EXPORT DEMAND. TODAY, NOT ONLY DOES THIS NOT EXIST, BUT EXPORTS HAVE CONTRACTED. THE INFLATIONARY AND ECONOMIC CRISIS IN GERMANY, AND IN ALL OF THE WESTERN WORLD, CAN NO LONGER BE SOLVED ON A NATIONAL BASIS. THE "IMPORTED RECESSION" (A MUCH REPEATED EXPRESSION) CAN ONLY PARTIALLY BE CUSHIONED BY DOMESTIC MEASURES. JOINT ACTION WITH OTHER COUNTRIES ON ECONOMIC POLICY IS NEEDED AND THE FRG HAS DONE WHAT WAS POSSIBLE IN THIS REGARD, WITH ATTENTION BEING SPECIFICALLY CALLED TO THIS SUMMER'S ACTIVITIES IN BRUSSELS, BONN AND HELSINKI.

E. THE EXPECTED DECLINE IN GNP IN 1975 WAS ATTRIBUTED EXCLUSIVELY TO THE IMPORTED RECESSION. DM 40 BILLION EXPORTS WILL BE LOST, WHICH IS EQUIVALENT TO 4 PERCENT OF THE GNP. THIS EXPORT DECLINE MEANS LESS INCOME, LESS PROFITS, LESS TAXES; AT THE SAME TIME IT

MEANS HIGHER GOVERNMENT EXPENDITURES FOR ECONOMIC STIMULATION PROGRAMS AND UNEMPLOYMENT BENEFITS. THE WORLD RECESSION AFFECTS THE PUBLIC SECTOR FINANCES THROUGH A REDUCTION OF TAX REVENUES AND THE CORRESPONDINGLY NECESSARY INCREASE IN EXPENDITURES.

F. THE CHANCELLOR RECOUNTED THE HISTORY OF THE GOVERNMENT POLICY RESPONSES TO THE ECONOMIC CRISIS. THE UNCLASSIFIED

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DISCONTINUATION OF EARLIER RESTRICTIVE PROGRAMS AND MEASURES TO STIMULATE INVESTMENTS WERE CITED, AND SO WERE THE TAX AND THE CHILDREN'S ALLOWANCES REFORM MEASURES TO STIMULATE PRIVATE CONSUMPTION. THE SUCCESSFUL RECORD IN KEEPING INFLATION DOWN WAS EMPHASIZED. THE BUNDESBANK'S CREDIT POLICY WAS NOTED AS BEING PARTICULARLY FAST AND EFFECTIVE IN REDUCING INTEREST RATES.

G. SOME PROGRESS HAS BEEN MADE: DOMESTIC DEMAND IN REAL TERMS IS 4 PERCENT HIGHER IN THE FIRST 7 MONTHS IN 1975 AS COMPARED WITH THE LAST 7 MONTHS IN 1974, WITH ORDERS FOR CAPITAL GOODS UP 17 PERCENT. THE CRITICISM OF THE INVESTMENT BONUS SCHEME IS UNJUSTIFIED. HOWEVER, THE HARD BEATING THE GERMAN EXPORTS HAVE BEEN TAKING HAS LARGELY CANCELED OUT THE EFFECT OF THE DOMESTIC MEASURES.

H. DM 5.2 BILLION OF THE DM 6.3 BILLION ADDITIONAL EXPENDITURES FOR 1975 ARE DUE TO ADDITIONAL SUBSIDIES OF THE UNEMPLOYMENT AGENCY. ON THE REVENUE SIDE, THERE ARE RECESSION-INDUCED SHORTFALLS IN THE AMOUNT OF DM 6.8 BILLION. MOREOVER, THERE IS A DM 2 BILLION SHORTFALL WHICH WOULD NOT BE THERE IF THE STATES HAD SETTLED FOR A REASONABLE COMPROMISE IN REDISTRIBUTING VAT RECEIPTS. FOR THE FIRST TIME SINCE 1949, THE BUNDESTAG MAJORITY AND BUNDESRAT MAJORITY ARE NOT COOPERATING; THE BUNDESRAT MAJORITY DOES NOT SHY BACK FROM USING THIS LEVER (FACT THAT BUNDESRAT APPROVAL IS REQUIRED) AGAINST THE WELL-FOUNDED CLAIMS OF THE FEDERAL GOVERNMENT.

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I. RE THE CREDIT TO POLAND, THE SUPPLEMENTAL BUDGET FOR 1975 CONTAINS COMMITMENT AUTHORIZATIONS, AND THE 1976 BUDGET DRAFT WILL PROVIDE FOR INTEREST SUBSIDIES IN THE AMOUNT OF DM 35 MILLION. THE DM 1 BILLION CREDIT IS TO BE RAISED IN A MANNER SPARING THE DOMESTIC CAPITAL MARKET TO THE GREATEST POSSIBLE EXTENT; THEREFORE, THE FIRST TRANCHE OF DM 340 MILLION IS TO BE RAISED ABROAD. IN THIS CONTEXT, SCHMIDT EMPHASIZED THE STABILIZING EFFECT FOR EMPLOYMENT IN THE FRG OF EXPORTS TO THE STATE TRADING COUNTRIES, WHICH, DURING THE FIRST SIX MONTHS, INCREASED BY 22 PERCENT, WHEREAS TOTAL EXPORTS DECLINE-
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J. BECAUSE OF THE NEED TO LEAVE LEEWAY FOR PRODUCTIVE INVESTMENTS -- PUBLIC AS WELL AS PRIVATE -- IN A FUTURE ECONOMIC RECOVERY, IT IS NECESSARY TO CURB, OVER THE MEDIUM-TERM, I.E., AS OF 1977, PUBLIC SECTOR BORROWING NEEDS. THE GOVERNMENT'S PROGRAMS CONSOLIDATE FEDERAL FINANCES THROUGH THE SEVENTIES AND ALSO HAVE A POSITIVE EFFECT ON STATE AND MUNICIPAL FINANCES. NOT ONLY THE FEDERAL GOVERNMENT, BUT ALSO THE STATES AND MUNICIPALITIES MUST MAKE ADDITIONAL EXPENDITURES IN 1975 AND 1976 FOR REASONS OF RECESSION AND FOR COUNTERCYCLICAL REASONS. IN ORDER TO FINANCE SUCH ADDITIONAL OUTLAYS, LESS IMPORTANT OUTLAYS MUST BE CUT AND HIGH CREDITS ARE NEEDED. IN TIMES OF ECONOMIC RECOVERY, HOWEVER, PUBLIC SECTOR BORROWING MUST NOT CONTINUE TO INCREASE, BECAUSE IT WOULD CONFLICT WITH PRIVATE SECTOR CREDIT NEEDS. THEREFORE, SUBSEQUENT PUBLIC SECTOR BORROWING MUST BE REDUCED, NOT ONLY BY SAVINGS BUT ALSO BY TAX INCREASES. BECAUSE OF THE RECESSION, IN 1976 THERE WILL BE FEDERAL TAX SHORTFALLS OF DM 20 BILLION. MOREOVER, THERE WILL ALSO BE RECESSION-INDUCED ADDITIONAL EXPENDITURES, ESPECIALLY FOR THE UNEMPLOYMENT AGENCY, IN THE ORDER OF MAGNITUDE OF DM 6 BILLION. THUS, THE RECESSION ALONE ACCOUNTS FOR DM 26 BILLION OF THE 1976 DEFICIT. WITHOUT THIS DM 26 BILLION AND WITHOUT THE LOSS ATTRIBUTABLE TO THE RIGID STAND OF THE STATES REGARDING DIVISION OF THE VAT PROCEEDS, THE DEFICIT WOULD AMOUNT TO ONLY DM 10.5 BILLION, WHICH CERTAINLY CANNOT BE REFERRED TO AS "FINANCIAL CHAOS".

K. IN OUR PRESENT ECONOMY DRIVE A SOCIALLY-BALANCED SOLUTION WAS NEEDED. THERE IS NO DOUBT THAT WE ARE DEMANDING A CERTAIN CUTBACK OF MANY A CLAIM. OUR CITIZENS UNDERSTAND THIS BETTER THAN THE PAID LOBBYISTS. THE CITIZENS UNDERSTAND IT BECAUSE THEY KNOW THAT WE CAN'T GAMBLE AWAY TODAY THE BASIS OF OUR PROSPERITY AND FINANCIAL SOLIDITY FOR TOMORROW AND THE DAY AFTER TOMORROW. WE ARE TIGHTENING OUR BELTS, STARTING FROM A REAL INCOME LEVEL OF OUR WORKERS IN WHICH WE HOLD THIRD OR FOURTH PLACE (DEPENDING ON THE EXCHANGE RATE) IN THE UNCLASSIFIED

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WORLD.

L. NET BORROWING REQUIREMENTS IN 1976 WILL BE AROUND DM 39 BILLION. THIS AMOUNT IS COMMENSURATE WITH THE UNDERLYING BUSINESS SITUATION. OPPOSITION SPOKESMEN HAVE PUBLICLY DEMANDED ADDITIONAL FEDERAL SAVINGS OF DM 7 - DM 10 BILLION. BY CONTRAST, THE IMF, THE OECD, ITALY,

ENGLAND AND HOLLAND HAVE DEMANDED THAT WE SHOULD SAVE LESS AND, INSTEAD, INCREASE DEFICITS FURTHER AND, OF COURSE, PUT UP WITH HIGHER PRICE INCREASES. THESE CRITICISMS OF SOME FOREIGN EXPERTS AND THE DOMESTIC OPPOSITION OBVIOUSLY CANCEL EACH OTHER OUT.

M. THE DECISION TO SEEK A VAT INCREASE NOW, BEFORE THE ELECTIONS, IS DESIGNED TO MAKE CLEAR TO ALL VOTERS JUST WHERE WE ARE HEADED. THIS CLARITY IS IMPORTANT ALSO FOR THE ECONOMY. BUSINESS CAN BE SURE THAT OTHER TAX INCREASES ARE NOT NECESSARY AND NOT INTENDED. BUSINESS CAN ALSO BE SURE THAT THE PUBLIC SECTOR, WHICH CURRENTLY ABSORBS DISPROPORTIONATELY HIGH SHARE OF PRIVATE SAVINGS, WILL RELIEVE THE CREDIT MARKETS OF ITS DEMANDS DURING THE RECOVERY PERIOD. THUS, THERE WILL BE ROOM FOR THE RESULTING INCREASED DEMAND FOR CREDITS TO FINANCE INCREASED PRIVATE INVESTMENTS, AND NEW INVESTMENT IS URGENTLY REQUIRED. AS OF 1977, INCORPORATING THE PROPOSED INCREASE OF 2 PERCENTAGE POINTS, THE FRG

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DEPARTMENT PASS TREASURY, FRB AND CEA

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TAGS: EFIN, GW
SUBJECT: CHANCELLOR'S ECONOMIC POLKCY STATEMENT IN
THE BUNDESTAG

REF: BONN 15019

WILL STILL HAVE ONE OF THE LOWEST VAT TAX RATES IN THE
EC. TAX HARMONIZATION IN THE EC IS IN THE OFFING.
(IMPLICATION: GERMANY WILL HAVE TO RAISE ITS RATES IN
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THE LONG RUN ANYWAY.)

N. REGARDING THE 1976 WAGE ROUND, THE GOVERNMENT
STICKS TO ITS STANDS THAT THE AUTONOMY OF THE MANAGEMENT
AND LABOR NEGOTIATING PROCESS WILL NOT BE TOUCHED.
HOWEVER, ALL PARTIES SHOULD REALIZE THAT THE STRENGTH-
ENING OF THE INVESTMENT QUOTA AND THE SAFEGUARDING JOBS
CLEARLY DESERVES PRIORITY OVER A FURTHER INCREASE IN
REAL WAGES. WE ARE IN THE TOP GROUP AS FAR AS WAGE
COST BURDENS ON PRODUCTION ARE CONCERNED. WAGE DEMAND
EXCESSES WOULD ENDANGER OUR INTERNATIONAL COMPETITIVE-
NESS, AND EXPORTS, AND THEREBY EMPLOYMENT AND PROFITS
WHICH ARE SO URGENTLY REQUIRED FOR FUTURE EMPLOYMENT.

THERE CAN BE NO DISPUTE OVER THE NEED FOR BUSINESS
PROFITS. IN THIS CONTEXT, IMPLIED WAS THAT IT IS
POSSIBLE, IN THE LONGER RUN, TO CONSIDER TAX CUTS FOR
BUSINESS.

O. THE GOVERNMENT'S ECONOMIC FISCAL POLICY
DECISIONS WERE CITED AS AN INDICATION OF A STRONG
GOVERNMENT, CAPABLE OF SUCH DIFFICULT ACTION BEFORE
AN ELECTION. THE OPPOSITION SO FAR HAS NOT PASSED THE
STAGE OF MERELY DEMANDING EVEN MORE FAR-REACHING
SAVINGS. HOWEVER, HE WHO WANTS TO GET BY WITHOUT A
TAX INCREASE AND WITHOUT HIGHER UNEMPLOYMENT INSURANCE
PREMIUMS WILL HAVE TO SAY JUST WHERE THE ADDITIONAL

SAVINGS ARE TO BE MADE AND WHO IS TO BE AFFECTED AND BY HOW MUCH. WITHOUT SUCH DETAILS, DEMANDS FOR MORE SAVINGS ARE MEANINGLESS.

3. IN CONTRAST TO THE CHANCELLOR'S DIAGNOSIS OF "IMPORTED RECESSION", OPPOSITION LEADER KOHL STATED: "THE MAJOR REASONS FOR RECESSION ARE HOMEMADE, AND FOR THAT YOU ARE RESPONSIBLE, MR. CHANCELLOR." LONG BEFORE THE WORLD-WIDE DOWNTURN OF EXPORTS AND THE ENERGY CRISIS OCCURRED, PRIVATE INVESTMENT PROPENSITIES HAD SHRUNKEN. EVEN AS LATE AS IN 1974, THE FRG'S EXPORT SURPLUS CLIMBED TO A RECORD OF DM 51 BILLION, BUT UNEMPLOYMENT NEVERTHELESS INCREASED TO MORE THAN 1 MILLION. IN 1969, BRANDT AND, LATER, SCHMIDT, TO OVER A HEALTHY UNCLASSIFIED

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ECONOMY, WHICH HAS NOW BEEN LED INTO A CRISIS, HE SAID. THE CURRENT SITUATION IS NOT DUE TO SHORT-TERM FAILURES, BUT IS THE RESULT OF POLICIES WHICH, BY SOCIALIST TENDENCIES, MUST HAVE A DETRIMENTAL EFFECT ON AN INDUSTRIALIZED ECONOMY, KOHL CHARGED. ACCORDING TO KOHL, THE GOVERNMENT'S PROGRAM IS A PARTIAL ADMISSION OF THE GOVERNMENT'S FAILURES. HE OFFERED COOPERATION IN OVERCOMING THE FINANCIAL CRISIS, BUT ONLY AFTER THE GOVERNMENT HAS PRESENTED A CONCLUSIVE CONCEPT AND THE TRUE DIMENSIONS OF THE FINANCIAL MISERY HAVE BEEN POLITICALLY ADMITTED.

4. OPPOSITION FLOORLEADER CARSTENS ACCUSED THE CHANCELLOR OF HAVING MISLED THE PUBLIC BY HAVING DESCRIBED FEDERAL FINANCES AS BEING IN ORDER, BY DENYING ANY INTENTIONS OF INCREASING THE VAT, AND BY PREDICTING AN EARLY UPSWING. WITH ITS PROGRAM, HE SAID, THE GOVERNMENT CONTINUED TO MISLEAD THE PUBLIC, BECAUSE IN REALITY IT IS NOT AN ECONOMY PROGRAM BUT RATHER A PROGRAM OF TAX INCREASES. LIKE KOHL, CARSTENS REFUTED THE CHANCELLOR'S BLAMING OF WORLD-WIDE RECESSION FOR RECENT DEVELOPMENTS. ACCORDING TO HIM, FOUR YEARS OF POOR ECONOMIC AND SOCIAL POLICIES ARE TO BE BLAMED. FOR YEARS, HE SAID, THE SPD HAS DISCREDITED BUSINESS AS PROFITMONGERS AND EXPLOITERS, CAUSING "HUGE UNCERTAINTIES". ACCORDING TO CARSTENS, ATTEMPTS TO OVERCOME THE PRESENT PROBLEMS BY TAX INCREASES WOULD BE A FUNDAMENTAL MISTAKE, DEMANDING INSTEAD A COMPREHENSIVE PROGRAM TO REVIVE ECONOMIC ACTIVITY AND SAFEGUARD EMPLOYMENT BY TAX INCENTIVES FOR INVESTMENT. CARSTENS' ADDRESS CULMINATED IN A SUGGESTION THAT THE CHANCELLOR TAKE THE "PERSONAL CONSEQUENCES" FOR HIS FUNDAMENTAL ERRORS.

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